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Supreme Court, U.S.
FILED
OCT 25 2004
OFFICE OF THE CLERK

No. 03-1583

IN THE

Supreme Court of the United States

HANDLEMAN COMPANY,

Petitioner,

v.

CAPITAL FACTORS, INC., KMART CORPORATION, KNIGHT-RIDDER, INC., AND IRVING PULP & PAPER, LTD.

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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INTRODUCTION

Capital Factors' Response Brief demonstrates why this Court should grant Handleman's Petition.

Capital Factors acknowledges that the Seventh Circuit's decision stands for the proposition that the reversal of the Critical Vendors Order is "binding on Handleman and all other Kmart creditors whether or not they received notice or participated in the appeal to the district court." Response at 8. This proposition is completely at odds with our legal system's fundamental concepts of jurisdiction and due process. Yet, the Seventh Circuit held that Handleman and the 2,327 other critical vendors who never had notice of the appeal to the district court, or the opportunity to be heard there, were effectively bound by the district court's determination that they should not have received the funds they were paid.

This Court should grant review to correct the pervasive bankruptcy practice - now formally embraced by the Seventh Circuit - that creditors must "accept" the outcome of an appeal to the district court that determines their property interests even where they are not a party to the appeal. App. 6a. Handleman's Petition raises constitutional questions that are critical to the fairness of our judicial system, and Handleman respectfully requests that the Court grant its Petition and address these questions.

ARGUMENT

I. THE DISTRICT COURT HAD NO JURISDICTION OVER HANDLEMAN

Capital Factors claims its appeal to the district court could bind Handleman, even though it was not a party, because the district court had *in rem* jurisdiction. According

to Capital Factors, "[t]he district court's reversal of the critical vendors order was an appropriate exercise of *in rem* jurisdiction that is binding on Handleman and all other entities." Response at 10.[1]

Even if the district court's jurisdiction was *in rem*, its reversal of the Critical Vendors Order did not bind Handleman because it was not a party to the proceeding and was given no notice of it. As this Court emphasized in *Mennonite Bd. of Missions v Adams*, 462 U.S. 791, 796-97 n.3 (1983):

> "The decision in *Mullane* rejected . . . that due process rights may vary depending upon whether actions are *in rem* or *in personam*."

See Tennessee Student Assistance Corp. v. Hood, 124 S. Ct. 1905, 1911 (2004) (even where a bankruptcy proceeding affords *in rem* jurisdiction, "a nonparticipating creditor cannot be subjected to personal liability")[2]; *Shaffer v. Heitner*, 433 U.S. 186, 206 (1977) (due process "rights cannot depend on the classification of an action as *in rem* or *in personam*"). Thus, whatever the basis of the district court's jurisdiction, its reversal of the Critical Vendors Order may not be applied to Handleman, a non-party.

The Seventh Circuit's decision - and the bankruptcy practice at issue here - fly in the face of the "deep-rooted historic tradition that . . . a judgment or decree among parties to a lawsuit resolves issues as among them, but it does not

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[1] The Seventh Circuit never even raised *in rem* jurisdiction as a basis for its decision.

[2] Contrary to Capital Factors' suggestion, *Tennessee Student Assistance Corp.* did not hold that a court with *in rem* jurisdiction may bind nonparties who are not given notice of the proceeding.

conclude the rights of strangers to those proceedings." *Richards v. Jefferson County*, 517 U.S. 793, 798 (1996). Handleman requests the Court to grant its Petition to review this matter.

II. HANDLEMAN'S DUE PROCESS RIGHTS WERE VIOLATED

According to Capital Factors, "Handleman had no due process interest at stake when the district court conducted its appellate review of the critical-vendors order." Response at 12. Capital Factors contends, as did the Seventh Circuit, that Handleman had no property interest at stake because it was not a "party" to the Critical Vendors Order.

Even if Handleman were not a party to the Critical Vendors Order (which Handleman disputes), Capital Factors' appeal undisputedly requested that the district court determine that Handleman should not have received $49 million and that Handleman be divested of these funds. Thus, Handleman, who was in possession of this $49 million at the time of Capital Factors' appeal, had an enormous property interest in defending the legal basis on which it was paid this sum. *Board of Regents of State College v. Roth*, 408 U.S. 564, 571-2 (1972) (property interests extend well beyond ownership of money). Handleman's property interest arose from its possessory interest in the $49 million, and this property interest did not depend on the merits of Handleman's contention that it had the right to keep the money. As this Court explained in *Fuentes v. Shevin*, 407 U.S. 67, 86-87 (1972):

> "[T]heir possessory interest in the goods . . . was sufficient to invoke the protection of the Due Process Clause.

> . . . The right to be heard does not depend upon an advance showing that one will surely prevail at the hearing. . . . It is enough . . . that a significant property interest is at stake, whatever the ultimate outcome of the hearing."

See Mathews v. Eldridge, 424 U.S. 319, 330 (1976) (the "constitutional challenge is entirely collateral to [the] substantive claim of entitlement").

Despite Handleman's property interest in retaining the $49 million, Capital Factors chose not to make Handleman a party to its district court appeal.[3] As a result, Capital Factor's appeal to the district court could not bind Handleman.[4]

This Court's unanimous decision in *Richards v. Jefferson County*, 517 U.S. 793 (1996) makes this point. There, even though an earlier lawsuit had unsuccessfully challenged an ordinance imposing a new tax, this Court held a new litigant had the unfettered right to challenge the same ordinance in a subsequent suit unaffected by the earlier suit because he was not a party to the first proceeding. This Court further held that it violated the new litigant's due

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[3] Capital Factors' failed to give Handleman notice of its appeal as a party even though Handleman was expressly named in the Critical Vendors Order as a recipient of the funds and Capital Factors knew Handleman's identity and contact information.

[4] Fed. R. Bankr. P. 8001 requires only that a notice of appeal be served on the parties to the order that is appealed. If a district court's resolution of a bankruptcy appeal binds only the parties who receive notice under Rule 8001, then Rule 8001's notice requirements comply with due process. If a district court's resolution of an appeal binds nonparties whose property rights are at issue, then the notice requirements of Rule 8001 do not secure the due process rights of these nonparties.

process rights to have the prior decision - even as precedent - applied to him.[5] 517 U.S. at 805.

The circumstances here are indistinguishable. Capital Factors' appeal to the district court challenged the propriety of the Critical Vendors Order. Because Handleman was not a party to that appeal, our system's most basic due process protections[6] require that the reversal of the Critical Vendors Order not apply to Handleman.

Given these circumstances, Handleman requests that this Court grant Handleman's Petition and review the bankruptcy practice by which persons whose property interests are at stake are not given notice of bankruptcy appeals to the district court, but then are supposedly bound by the outcome of those appeals.

CONCLUSION

Handleman requests that the Court: grant *certiorari*; reverse the Seventh Circuit; and hold that the reversal of the Critical Vendors Order did not bind Handleman or the other

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[5] "A state court's freedom to rely on prior precedent in rejecting a litigant's claims does not afford it similar freedom to bind a litigant to a prior judgment to which he was not a party." *Richards,* 517 U.S. at 805.

[6] Capital Factors contends that bankruptcy proceedings are excepted from these fundamental guarantees. However, this Court has expressly stated that bankruptcy proceedings may terminate property interests only if the procedures are "consistent with due process." *Richards*, 517 U.S. at 798. *See City of New York v. NY, NH & H RR Co.*, 344 U.S. 293 (1953) (applying due process protections to bankruptcy proceedings).

2,327 critical vendors who were not parties to Capital Factors' appeal to the district court.

Respectfully submitted,

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Dated: October 25, 2004